

DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92038

36 Letters per Year

Registered with the Securities Exchange Commission

September 24, 1976

Letter 676

Sept. 10, DJIA 988.36; PTI 703; A-D Ratio -22.25

Sept. 17, DJIA 995.10; PTI 715; A-D Ratio -21.74

ALL RIGHT! We've been waiting month after month for two events, and they both happened last week. The Advance-Decline ratio climbed to a new bull market high. And the D-J 20 Bond Average bettered its 1973 peak, thereby signaling a bull market in bonds. From here on the story will be told by the D-J Industrials and Transports. If they confirm on the upside (to new bull market highs), Wall Street's going to be a good place to be. If they don't then we'll have something new to worry about. So far, this bull has to "come through" on the upside, despite any and all technical problems.

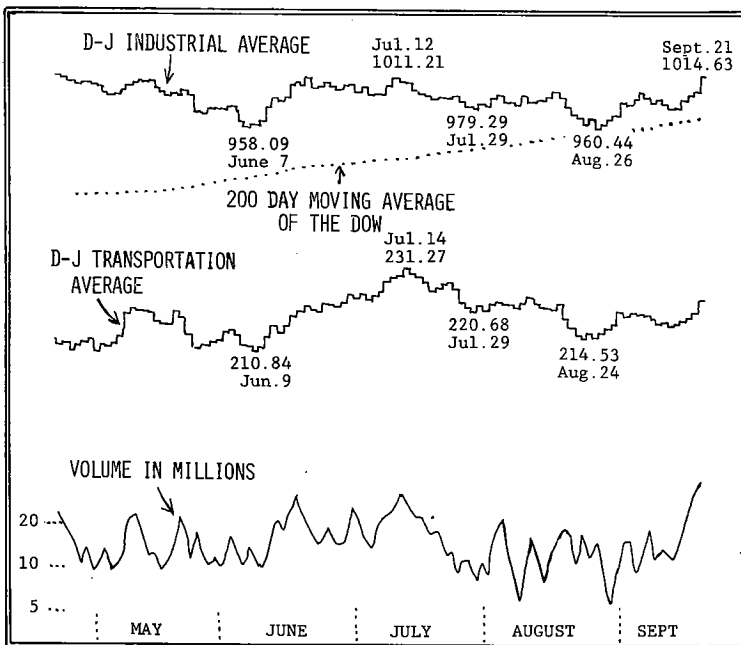
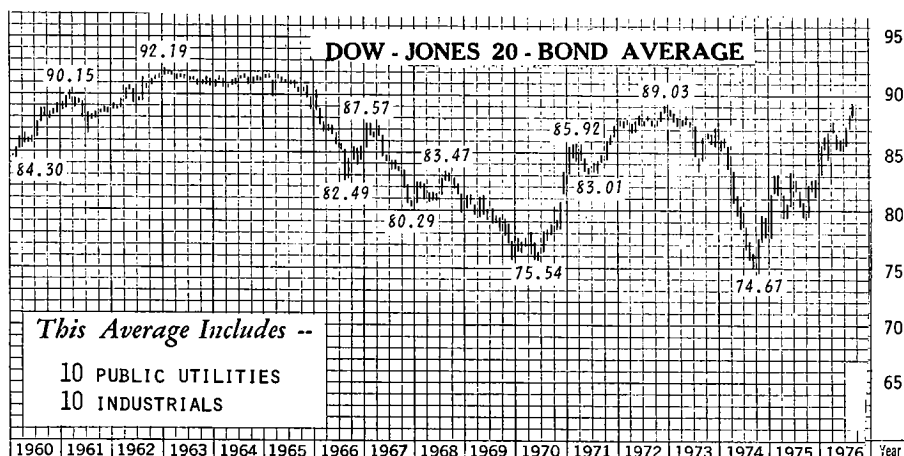
We'll continue to sit tight with the bull market. And we'll continue to give the bull the benefit of all doubts. Frankly, I've seen "easier" and "cleaner" bull movements than this one. But as I've said so many times before, they don't run the market for Richard Russell's benefit.

BOND BULL MARKET: Last week the D-J Bond Average (now 20-bonds instead of the previous 40-bonds) did something it hasn't been able to do in thirty years, or ever since the bond market peak of 1946. Last week the D-J 20-Bond Average advanced above a previous major peak. This event occurred following a huge "double bottom" formed during the 1970 to 1974 period. The rise of last week confirms what I have been talking about for over a year. We now have a primary bull market in bonds for the first time since the 1940's!

Study the accompanying monthly chart (courtesy of HORSEY, Salisbury, MD 21801). This is the first long-term chart available for the D J 20-Bond Average. What we see here is a dynamic advance of the 20-Bond Average from the approximately 30-year low of 74.67 recorded in 1974 to last week's 10-year high of 89.07! The 20-Bond Average has now advanced about 20% from its 1970 low, an amazing feat. Since the Bond Average is now above its 1973 high, it makes little difference whether it now corrects or not (obviously, I am pleased that any potential correction now must come after a confirmed bull market, not before).

What is the great bond market performance really telling us? First, I think it is telling us that for whatever reason, interest rates are coming down (the prime rate was cut to 6.75% at leading banks last week). The bond advance is suggesting stable business (certainly not a boom), or it could mean more conservatism in Government (unlikely as that sounds).

The bull market in bonds is telling us that the dollar is probably going to be stable to strong over the foreseeable future. And the bond advance is also indicating a declining rate of inflation during the rest of 1976 and into 1977. It is worth noting that inflation is now taken for granted in most quarters. In fact, the only argument among economists concerns how high the rate of inflation is going to be. But the bond market is saying that there may be something wrong with the consensus thinking. The bonds could be telling us that years of inflation may be giving way to a persistent rate of high unemployment or perhaps to a new wave of conservatism on the part of the consumer. Personally, I believe that the American public has been remarkably calm about the high unemployment. It could be that Ford and Carter sense this, and that they will ultimately understand that Americans are ready to accept a slower economy and high unemployment in lieu of perpetual inflation. Remember, politicians are (if nothing else) sensitive to the public mood.



The fact is that a rising bond market and a falling rate of inflation are both long-term bullish for the stock market and for the nation. I really think that most people in their hearts are relieved at the current "lack of boom," the feeling of stability, the fact that the dollar has been gaining power and respect during 1976 (while many other currencies have been falling on their respective fannies). Good Lord, even New York City may be coming back. The "Big MAC" bonds have been acting well, nobody's talked about Gotham going bankrupt in over a month now, and the September 20 issue of New York magazine boasts a cover story entitled, "A Great New Spirit." The subtitle adds, "Don't Ask Why, but Things Are Looking Up." It's taken a primary bull market to do it, but my home town may yet stagger to its feet. Is this the millennium?

WATCH WALL STREET: It doesn't pay to be a wise guy where a bull market or a bear market is concerned. I don't know how many investors I've seen broken, not by the market, but by their own stubbornness and arrogance. The market is always the boss. You either listen to the boss or you lose. That's called humility on Wall Street. I've known a lot of men (investment letter writers included) who tried to tell the boss what to do. They often look good—for awhile. Almost all of them are in different businesses today.

This is a primary bull market. In a bull market the trend is up but the bull trend is also subject to corrections. And the correction can occasionally be costly. The primary or great tidal trend of the market has been bullish ever since late-1974. We received a primary bull signal on January 27, 1975, confirming this fact. Under Dow Theory, once a trend is in force we take it to remain in force until proved otherwise. As far as I'm concerned, there is nothing to suggest that the primary trend of this market is anything but bullish at this time.

The secondary trend turned bullish in October, 1975 (following a three-month correction). Under Dow Theory, the secondary trend has remained bullish ever since. True, we have had non-confirmations, we have had lags, we have had minor declines, we have had exasperating sideways action. None of that proves that the secondary trend at this time is anything but bullish.

Since February, 1976, we have seen a number of developments which have "bothered me," developments that I would have preferred had not occurred. Yet they are all straws in the wind in the face of the basic Dow Theory principle which states that a trend once in force remains in force until proved otherwise. In view of all this, I advised some caution (scaling back of weaker issues) over the past few months. But my basic message all along has been that as long as the D-J Industrials and Transports hold above their June, 1976 lows of 958.09 and 210.84 respectively, the secondary trend must be considered to remain bullish.

Our eyes have been on the Industrial Average and the A-D ratio ever since the A-D peak of February 24, 1976. On April 21 the Dow pushed to a new bull market peak of 1011.02. The A-D did not confirm. On July 12 the Dow climbed to another bull market high of 1011.21. Again the A-D refused to confirm. That constituted a five month lag in the A-D (a five-month non-confirmation) and I wrote that unless the A-D came through, we were going to have trouble.

The market sagged following the mid-July peaks, a decline that carried to the August 24 lows. From there the character of the price movement began to change. Ironically, after late-August it was the A-D which showed strength while the Dow lagged. On September 20 it happened. The A-D ratio (see chart) rallied to a new bull market high. The next day saw the market literally come to life with strength across the board from the Dow to the Transports, from the Utilities to the secondary issues.

Behind it all lies the amazing power of the bond market, the steady decline of interest rates, the build up of liquidity. This is a phenomenon which I have been writing about all year, and as noted earlier, this market now has the full power of a primary bull market in bonds behind it. This is a force which has not blessed Wall Street in thirty years or ever since 1946. The power of a bull market in bonds is one that the great majority of today's brokers and investors have never seen before. It can be formidable, to say the least.

From a technical (and historical) standpoint, we now have the Industrials surging into one of the great resistance areas of stock market history. The 1949 to 1966 bull market topped out at 995.15 (February, 1966), and twice more (1968 and 1973) the 1000 area turned the Dow away in no uncertain manner. From the 1973 high (1051.70), the Dow splintered and crashed, breaking to almost half of its former high.

Now again we see the Dow push up and into the 1000 zone. But this time we have a two-year old bull market (and this is a young bull), we have a market that is in its second (not third) phase, we have a market that has a powerful monetary foundation under it in the form of a primary bull market in bonds.

"How high could this move go?" one asks. There is only one answer to this question that has withstood the test of time. That answer is provided by Robert Rhea, the great Dow Theorist of the 1930's. "Neither the extent nor the duration of a primary movement," wrote Rhea, "can be predicted in advance."

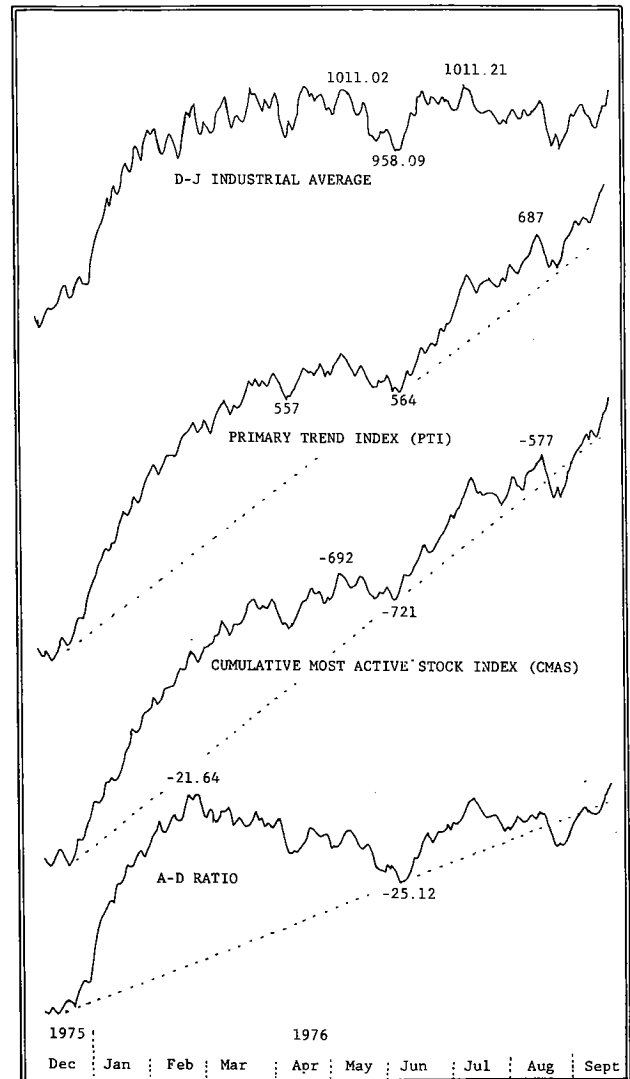
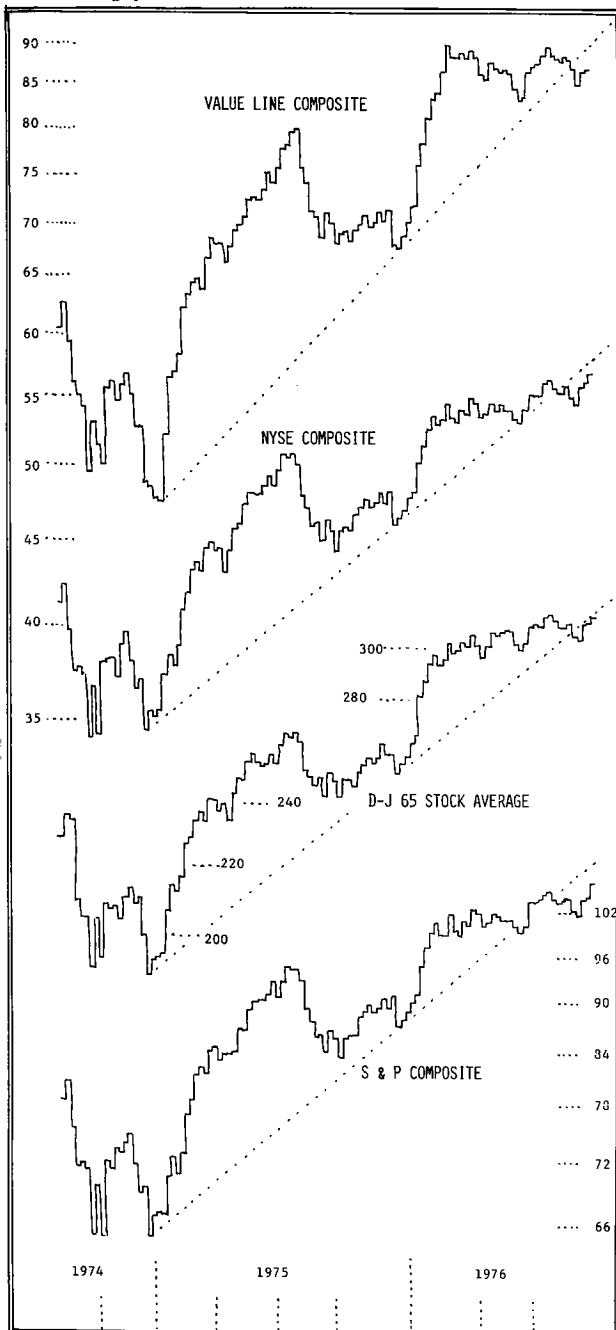
"What kind of an answer is that?" you retort. And my answer is that it's the only answer worth a damn. What Rhea was saying, of course, is that where a primary movement is concerned, it is best to kick out all your preconceived notions, to jettison all your brilliantly conceived scenerios. Subscribers may remember the national reaction of disbelief and even anger when this writer called a primary bull market on January 27, 1975. Many analysts and most of the public still do not accept that bull market thesis. But a lot has happened since late-1974 and early-1975, and you were either with it or left out. The same may be said when I called a bear market in gold, even though almost none of us (at the time) envisioned the depths to which the primary trend would send the gold shares.

Primary movements are, and always have been, laws unto themselves. We are in a primary bull market now. The secondary and minor trends are bullish, and the bull is now lowering his horns as he charges into the great (literally fabled) resistance zone

of 1000 to 1050 on the Dow. If the Averages can now smash through to new highs (Industrials above 1011.21, Transports above 231.27), the market will be in the full grip of the bull. Where the top will ultimately come is beyond the ken of anyone (except the crystal ball gazers and the liars). What I hope to do is identify the area of the top. That next top, I might add, will not be the end of the bull market. But it will terminate the second phase of the bull.

Question: Does last week's action change your mind regarding the gradual break-up of the second phase of this bull market?

Answer: If the D-J Averages confirm the September 20 action of the A-D ratio by bettering their 1976 highs, I would certainly say that the second phase of the bull market is very much in force. I would be surprised if new highs all around in the Averages and the various indicators were not indicative of a powerful move which might extend the second phase of the bull market perhaps into 1977. At any rate, readers of these reports should be in good shape and ready for anything which may occur in the period ahead. With both bonds and stocks moving up, I would simply sit back and watch the action.



TECHNICAL RUNDOWN: A number of developments have materialized over the past week, and I want to review them because they are positive. The action of the A-D ratio has already been covered.

On September 17 we had new highs in two important composite Averages, the Standard & Poor 500 and the very important NYSE Composite. As you can see on the chart, this is half our battery of four major composites, and if the Dow 65 and Value Line go through on the upside (see chart), I would term this a strongly bullish item.

The Cumulative Most-Active Stock Index (CMAS) and my Primary Trend Index (PTI) have been climbing skyward. These two indicators (see chart) have been powerhouses all during the sideways movement of the past seven months. I can't see the market breaking down while the CMAS and PTI continue to probe the upper reaches. It's simply a question of whether these two fellows are going to drag the rest of the market (kicking and screaming) with them to new bull market highs. It happened in late-1975, and it could happen again.

I keep a rather unique chart of NYSE highs for the week (page 4). These are the M/G Financial statistics based on a running 52-week model, and it is not based on the Dow Jones method of showing new highs through March of each year and then reverting back to the preceding January. Thus the 52-week method is much more accurate, more significant and needs no adjustments.

A second interesting factor is that the M/G Financial new high figures are for common stocks only, not for preferred. I translate these figures

Page 4 into a percentage so that what you see on the chart is the percentage of common stocks hitting new highs each week (based on the last 52 weeks).

Note that the percentage of new highs hit a major peak of 33% last February. The new high percentage then slid for six months to a low of 1.4% in August. But last week the percentage jumped to 9.2%, and this figure penetrated the descending trendline which has been in force since the February peak. That means that on a trend basis, the new high percentage is now moving up. And that should be bullish. Obviously, there's nothing that stirs the heart of the investor as much as a list of his own stocks that are dotting the new high lists.

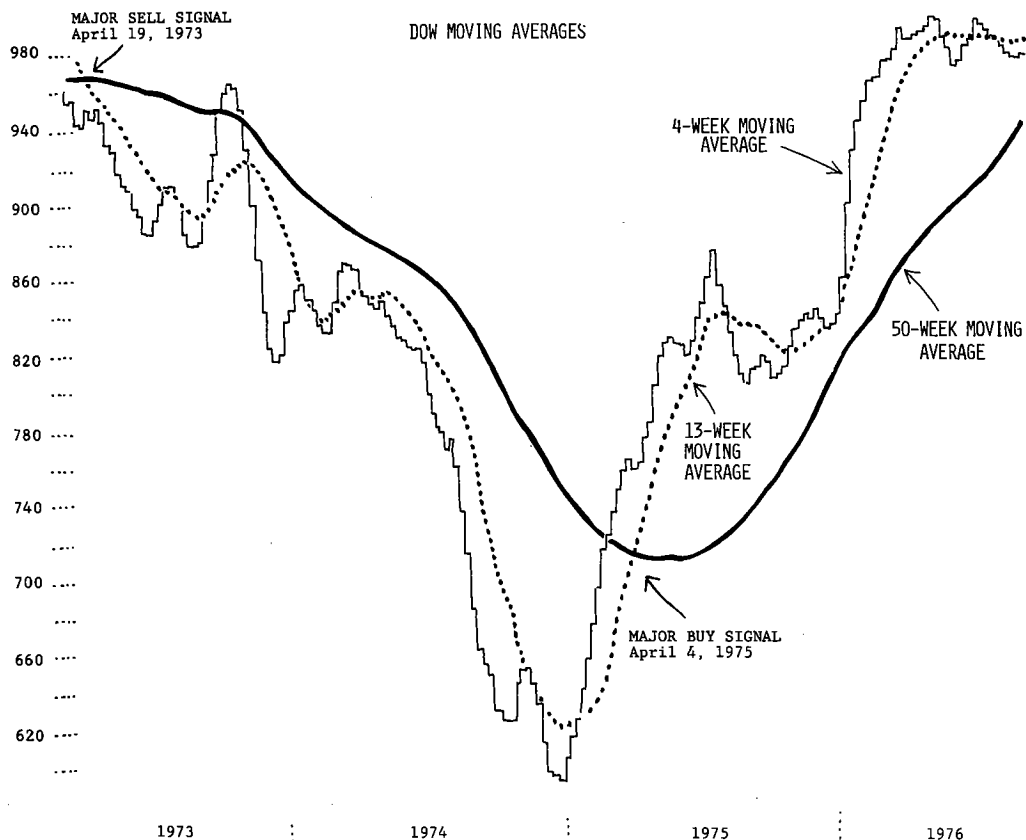
DOW MOVING AVERAGES: We have a "fail safe" device for the stock market. It is a technical study, and it is also about as mechanical as anything I ever present in these reports. This device is the inter-relationship of the three Dow moving averages. The accompanying chart labels the three Dow MA's which I use. We have a short-term or 4-week MA, an intermediate or 13-week MA, and a long-term or 50-week MA. Buying or selling alerts are given when the 4-week MA moves above or below the 13-week MA. Major buy or sell signals are given when the 13-week MA rises above or falls below the 50-week MA.

There is some interpretation involved in this study. I give a signal most emphasis when it occurs in the same direction as the primary trend. I also give a signal increased emphasis if the MA is rising or declining in harmony with the buy or sell signal.

For instance, an initial sell alert was given on May 27, 1976. I did not attach too much significance to this signal because at the time the 13-week MA was rising slightly (when the 4-week MA broke below it). The sell alert was also against the primary bull trend.

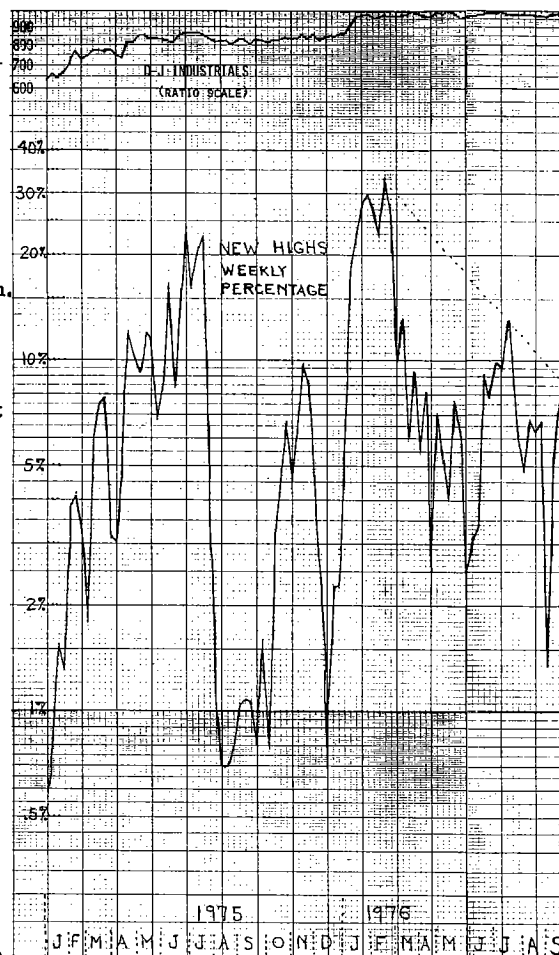
A second sell alert was given on August 13, and this one bothered me a bit because at the time of the second sell alert the 13-week MA was moving down. But the primary trend of the market is bullish, and this must underscore all our thinking with indicators and moving averages. Furthermore, the construction of the MA's is such that nothing in this study can happen "in a hurry." The MA technique allows the market time and prevents precipitous and emotional action on our part.

The important signals (the ones we never ignore) are the major buy and sell signals which are given when the 13-week MA crosses



above or below the 50-week MA. Currently, the 13-week MA stands at 987 and the 50-week MA is at 945. This means that the 13-week and 50-week would have to close by a distance of 42 points in order to provide a major sell signal. This is a fairly large distance, and even if the Dow was to turn outstandingly weak, it would probably take until late-October for such a signal to materialize. Interestingly, history shows that the major buy and sell signals given under this study arrive soon enough so that the investor tends to make his move during the early part of any extended advance or decline. The conclusion under this study is that the important 13-week and 50-week MA's remain in a bullish relationship with each other.

A second study (updated from the last Letter) which could provide more sensitive evidence



of impending trouble would be the study of the Dow and its 200-day MA (see chart). So far, during the entire span of this primary bull market the Dow has refused to break below its 200-day MA. The Dow touched the 200-day MA twice during late-1975 as that correction wore itself out. And again during the first week of September, 1976 the Dow retreated and then touched the 200-day MA. But so far, the area of the 200-day MA has provided strong support for any and all retreats by the Dow.

When the stock market does something new (alters its prevailing pattern), it is always time to stop, look and think. For this reason, if during the months ahead, the Dow finally does turn down and break below its 200-day MA, it would be well to accept this as a change from the last two years' action (and a bearish change). But so far, this kind of action has not occurred. The Dow remains bullishly above its 200-day MA, which now stands at 969.

NEW ORLEANS, THE MONETARY CONFERENCE: N.O. is one of the three or four utterly different cities in the US. New York is another, San Francisco is a third. N.O. offers many plusses such as great food (probably due to its French background and history), outstanding tradition (and they are very proud of it), free atmosphere (anything seems to be accepted in N.O.), and remarkable contrasts (like New York, N.O. seems to have the best and worst of everything).

At least in public, racial integration in N.O. is complete, far surpassing almost all other cities (North or South) that I have seen. Blacks and whites work together. We saw very little or no resentment, no incidents at all (and the black population of N.O. is huge). Service in N.O. is superb. For instance, where you can't get anyone to help you in Vancouver (you can't even get a taxi), everyone in N.O. jumps to help you. It's an out-of-towner's paradise.

One meal at Le Ruth (a fabulous, world famous restaurant) and your trip to N.O. is worthwhile. It's strange, but I found the N.O. people heavy, sort of dragging, many overweight. I really believe it's the climate, which is wet, super-wet, or sopping. When the sun comes out in N.O. and the temperature hits 90, brother you'd better get to a bar and sip a New Orleans "Hurricane" (which is just about what everybody does).

A nocturnal stroll down Bourbon Street is a sight you'll never forget. Here in the French Quarter every night is a celebration. After dark the streets are blocked to traffic and thousands of people simply wander back and forth, drinking, gaping, dancing, doing their thing. If they don't display it or sell it on Bourbon Street, I doubt that it exists. Famous jazz bands play, restaurants sell, girly shows abound, and incredibly, people live upstairs in almost every house in the Quarter. How they sleep with that unbelievable racket will forever be a mystery to me (many bars stay open 24 hours in N.O.). N.O. subscribers may complain that I'm skipping all the lovely parts of town (much of which we saw). But every city has lovely houses and a few beautiful parks. Only one city has the French Quarter plus the Mississippi running through it plus dozens of great restaurants plus Bourbon Street.

My main complaint about N.O. (aside from the weather) is the filth. N.O. has to be one of the dirtiest cities I have ever seen. You could spend a billion dollars cleaning up N.O. (and it probably wouldn't be a bad investment). If I were mayor, I would sand-blast the entire town, then scrub it down with a strong solvent, then cement it back together.

The Monetary Conference: too many speakers, but it was good to see them all, many being old friends. My impression was that the gold and monetary people spend too much time listening to each other. Personally, I learn more listening to markets. I was amazed at the number of people who had ridden their gold shares all the way down. Two dozen people must have stopped me and said, "If I had only listened. I read your Letter, but for some reason . . ." What can I say? "Put it all down to experience" is about all you can come up with. But it's a very expensive lesson.

I was surprised at how few speakers talked about markets (I think only C.V. Myers and myself). But markets are what fascinate me, and markets are what we must deal with. Many of the speeches were highly instructive, but my feeling is that they could have been made two years ago or a year ago, and the same speeches could probably be made next year. It's the market I have to deal with and my subscribers have to deal with. Just tell me which way gold is going or silver or the stock market. I'd rather be right in a stock I hate than wrong with gold (which I like because it's real, honest money).

It was a sprightly yet conservative crowd at the Conference. And it was a pleasure to see so many people I have corresponded with but never actually met. I particularly enjoyed meeting Mike Kaller, internationally-known stamp expert, and Judy Frank, equally well-known coin expert. Renee Baxter (beard and all) was there (he's the Libertarian author of "The Freedom Fighter"), Fred Macaskill of S. Africa, Ian McAvity of "Deliberations," (mmm, all three had beards). Talked to fighting C.V. Myers, Big John McFalls ("The Voice of Gold"), Ed Hargitt, Julian Snyder ("Moneylines"), and on and on. I really enjoyed seeing many of my own subscribers, and I want to thank them for being so kind to us on our trip. A final thought: if New Orleans only had San Diego's weather and if San Diego only had N.O.'s restaurants (some day, some great chef is going to come to San Diego, open the first outstanding restaurant in this town, and make \$5 million his first year).

